

***Universal Service
Administrative Company
("USAC")***

*Audited Financial Statements for the
Years Ended December 31, 2002 and 2001*



INDEPENDENT AUDITORS' REPORT

To the Board of Directors of the
Universal Service Administrative Company:

We have audited the accompanying statement of financial position of the Universal Service Administrative Company (a Delaware corporation) (the "Company") as of December 31, 2002, and the related statements of operations and change in unrestricted net assets and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the Company as of December 31, 2001 and for the year then ended were audited by other auditors who have ceased operations. Those auditors expressed an unqualified opinion on those financial statements in their report dated April 29, 2002.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Universal Service Administrative Company as of December 31, 2002, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States.

A handwritten signature in black ink that reads "Deloitte & Touche LLP". The signature is stylized and cursive.

February 28, 2003

UNIVERSAL SERVICE ADMINISTRATIVE COMPANY

STATEMENTS OF FINANCIAL POSITION DECEMBER 31, 2002 AND 2001 (in thousands)

	<u>ASSETS</u>	<u>2002</u>	<u>2001</u>
CURRENT ASSETS:			
Cash and cash equivalents (Note 2)		\$ 514	\$ 2,595
Receivable from Federal Universal Service Fund ("USF") (Note 2)		2,480	2,304
Interest receivable		7	6
Prepaid expenses and other current assets		589	1,352
		<u>3,590</u>	<u>6,257</u>
RESTRICTED NET ASSETS (Note 3):			
Net assets applicable to Federal USF		<u>2,491,058</u>	<u>2,572,476</u>
Total current assets		<u>2,494,648</u>	<u>2,578,733</u>
FIXED ASSETS, less accumulated depreciation and amortization of \$762 and \$2,036, respectively (Note 2):		<u>584</u>	<u>1,047</u>
Total assets		<u>\$ 2,495,232</u>	<u>\$ 2,579,780</u>
<u>LIABILITIES AND UNRESTRICTED NET ASSETS</u>			
CURRENT LIABILITIES			
Accounts payable and accrued expenses (Note 2)		\$ 4,174	\$ 7,304
RESTRICTED NET LIABILITIES (Note 3)			
Net funds held for Federal USF		<u>2,491,058</u>	<u>2,572,476</u>
Total current liabilities		<u>2,495,232</u>	<u>2,579,780</u>
COMMITMENTS AND CONTINGENCIES (Note 6)			
UNRESTRICTED NET ASSETS		<u>-</u>	<u>-</u>
Total liabilities and unrestricted net assets		<u>\$ 2,495,232</u>	<u>\$ 2,579,780</u>

The accompanying notes to financial statements are an integral part of these statements.

UNIVERSAL SERVICE ADMINISTRATIVE COMPANY**STATEMENTS OF OPERATIONS AND CHANGE IN UNRESTRICTED NET ASSETS****DECEMBER 31, 2002 AND 2001**

(in thousands)

	<u>2002</u>	<u>2001</u>
REVENUE:		
Contract revenue	<u>\$ 46,192</u>	<u>\$ 39,284</u>
OPERATING EXPENSES:		
Contractual expenses (Notes 1 and 6)	36,438	30,275
Personnel and related expenses	5,502	3,851
General and administrative	3,402	4,292
Depreciation and amortization	850	866
Total operating expenses	<u>46,192</u>	<u>39,284</u>
Net income	-	-
UNRESTRICTED NET ASSETS, beginning of year	<u>-</u>	<u>-</u>
UNRESTRICTED NET ASSETS, end of year	<u><u>\$ -</u></u>	<u><u>\$ -</u></u>

The accompanying notes to financial statements are an integral part of these statements.

UNIVERSAL SERVICE ADMINISTRATIVE COMPANY

STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2002 AND 2001 (in thousands)

	<u>2002</u>	<u>2001</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from contributors	\$5,174,622	\$ 5,238,714
Interest received	44,811	95,934
Cash paid to service providers	(5,195,897)	(4,623,594)
Cash paid for administrative costs	(47,709)	(37,271)
Less: Net cash used for (provided by) Federal USF	22,479	(672,148)
Net cash (used for) provided by operating activities	<u>(1,694)</u>	<u>1,635</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Redemption of short-term investments	588,342	2,025,627
Purchase of short-term investments	(431,761)	(1,495,113)
Cash paid for fixed assets	(387)	(105)
Less: Net cash (provided by) Federal USF	(156,581)	(530,514)
Net cash used for investing activities	<u>(387)</u>	<u>(105)</u>
(Decrease) increase in cash and cash equivalents	<u>(2,081)</u>	<u>1,530</u>
CASH AND CASH EQUIVALENTS, beginning of year	<u>2,595</u>	<u>1,065</u>
CASH AND CASH EQUIVALENTS, end of year	<u><u>\$ 514</u></u>	<u><u>\$ 2,595</u></u>
RECONCILIATION OF NET CASH FROM OPERATING ACTIVITIES:		
Net income	\$ -	\$ -
Adjustments to reconcile net income to net cash (used for) provided by operating activities-		
Depreciation and amortization	850	866
Changes in operating assets and liabilities-		
(Increase) decrease in interest receivable	(1)	13
Decrease (increase) in prepaid expenses and other current assets	763	(929)
Decrease (increase) in restricted net assets applicable to Federal USF	81,418	(745,635)
(Increase) in receivable from Federal USF	(176)	(391)
(Decrease) increase in accounts payable and accrued expenses	(3,130)	2,076
(Decrease) increase in restricted net funds held for Federal USF	<u>(81,418)</u>	<u>745,635</u>
Net cash (used for) provided by operating activities	<u><u>\$ (1,694)</u></u>	<u><u>\$ 1,635</u></u>

The accompanying notes to financial statements are an integral part of these statements.

UNIVERSAL SERVICE ADMINISTRATIVE COMPANY

NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2002 AND 2001
(in thousands)

1. ORGANIZATION AND BASIS OF PRESENTATION

The Universal Service Administrative Company ("USAC" or the "Company") was incorporated, effective September 17, 1997, as a not for profit independent wholly-owned subsidiary of the National Exchange Carrier Association, Inc. ("NECA"), and appointed by the Federal Communications Commission ("FCC") to administer the Federal Universal Service Fund ("USF") and has no ownership or control over the USF. USAC's Board of Directors consists of independent directors representing a cross-section of stakeholders in the Federal USF.

The FCC, in its Report and Order in CC Docket Nos. 96-45 and 97-21 ("Universal Service Order") released May 8, 1997 and November 20, 1998, respectively, determined that USAC should serve as the permanent administrator of the high cost, low income, rural health care, and schools and libraries universal service support mechanisms, collectively referred to herein as the "Support Mechanisms," established pursuant to Section 254 of the Communications Act of 1934, as amended.

USAC performs billing, collection and disbursement functions for all the Support Mechanisms. It also collects information regarding contributing entities' and end-user telecommunications revenues, submits projections of demand, administrative expenses for the Support Mechanisms and quarterly universal service contribution data to the FCC.

The functions of USAC also include, but are not limited to: development of applications and associated instructions as needed for the Support Mechanisms, administering the application process to ensure compliance with FCC rules and regulations, creating and maintaining a web site and related operational infrastructure for such processes, performing outreach and public education functions, authorizing audits of telecommunication carriers, schools, libraries, and rural health care providers, and development and implementation of other functions unique to the Support Mechanisms.

Funds collected from contributors by USAC are restricted as to their intended use related to the Support Mechanisms discussed above. Accordingly, such funds, together with related assets and liabilities have been reflected as restricted net assets applicable to Federal USF in the accompanying statements of financial position. Available funds are maintained and invested by USAC.

NECA performs certain administrative services for USAC under contract whereby NECA is compensated by USAC in accordance with NECA's Cost Accounting and Procedures Manual. Effective July 1, 2002, NECA entered into a fixed price contract with USAC for services performed for the Schools and Libraries and Rural Health Care Support Mechanisms. For the years ended December 31, 2002 and 2001, the expense recognized for services rendered by NECA were \$32,909 and \$28,526, respectively, and is included in contractual expenses in the accompanying statements of operations. At December 31, 2002 and 2001, the amounts due to NECA related to these services were \$3,006 and \$6,115, respectively.

UNIVERSAL SERVICE ADMINISTRATIVE COMPANY

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2002 AND 2001 (in thousands)

2. ACCOUNTING POLICIES

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The allowance for doubtful accounts represents a reserve estimate for amounts billed to contributors that may be uncollectible. The allowance includes specific reserves for identified bankruptcies and general reserves based on management's assessment of the recoverability of accounts receivable. Management periodically reviews such estimates and it is reasonably possible that management's assessment of recoverability may change based on actual results.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentration of credit risk consist principally of cash, cash equivalents, short-term investments and receivables from contributors. The Company places its cash, cash equivalents and short-term investments with high-credit, quality institutions and limits the amount of credit exposure to any one institution. The Company's accounts receivable arise from amounts billed to contributors but unpaid. The Company performs ongoing evaluations of the recoverability of the receivables and provides allowances for amounts that may be uncollectible.

Cash and Cash Equivalents

USAC considers all highly liquid securities, purchased with an original maturity of three months or less, to be cash equivalents.

Short-Term Investments

USAC considers all securities purchased with an original maturity greater than three months but less than or equal to one year to be short-term investments. Short-term investments consist primarily of investment grade marketable debt securities with readily determinable fair values all of which are classified as held-to-maturity. The Company accounts for its investments in accordance with Statement of Financial Accounting Standards ("SFAS") No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*. Under SFAS No. 124, a not for profit organization reports investments in debt and equity securities at fair market value.

Fixed Assets

Fixed assets consist of furniture, equipment, leasehold improvements and software and are carried at cost. Depreciation of furniture and equipment is calculated on a straight-line basis over the estimated useful lives of those assets (five to seven years). Amortization of leasehold improvements is calculated on a straight-line basis over the remaining period of the respective leases or estimated useful lives of the improvements,

UNIVERSAL SERVICE ADMINISTRATIVE COMPANY

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2002 AND 2001 (in thousands)

whichever is less. Amortization of software is calculated on a straight-line basis over the estimated useful lives of those assets (three years). Maintenance and repairs are charged to operations as incurred.

Impairment of Long-Lived Assets

The Company evaluates long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may no longer be recoverable. If the estimated future cash flows (undiscounted and without interest charges) from the use of an asset were less than the carrying value, a write-down would be recorded to reduce the related asset to its estimated fair value.

Receivable from USF

Receivable from USF presented on the USAC statements of financial position as of December 31, 2002 and 2001 consists of amounts owed USAC from the USF for accounts payable and accrued expenses incurred by USAC net of assets available to satisfy those obligations.

Contract Revenue

USAC recognizes contract revenue when services are rendered. Contract revenues are equal to the cost of providing administrative support to the Support Mechanisms.

Amounts Billed to Contributors

Contributors to the USF are permitted to revise their revenue data, which may result in adjustments to amounts previously billed. Billing adjustments are calculated upon receipt of the revised revenue data and recorded when approved and then billed or credited to the contributor. The Company accrues known and unbilled adjustments resulting from revised revenue data received from the contributors before year end.

Payable to Service Providers

Payable to service providers reflects amounts that have been approved for payment by the various Support Mechanisms but have not yet been disbursed. The Company recognizes the obligation upon review and approval of the submitted payment requests as specified in the Support Mechanism rules.

Payable to Contributors

Payable to contributors represents contributors' credit balances primarily due to overpayments and other adjustments.

Amounts Paid and Due to Service Providers

Amounts paid and due to service providers are presented as a gross amount. However, during 2002 and 2001, service providers receiving support from Schools and Libraries Support Mechanism had the option to net their support due from Schools and Libraries Support Mechanism against their payments relating to all four of the Support Mechanisms comprising USF. It is mandatory that providers receiving support from the

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NOTES TO FINANCIAL STATEMENTS
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(in thousands)

Rural Health Care Support Mechanism net their support due against their payments to USF. There is no provision that enables providers to net their support due from High Cost and Low Income Support Mechanisms against their contributions to USF.

Amounts paid and due to service providers through certain Support Mechanisms are based on estimates and provider data that may be subject to subsequent revisions. These revisions may result in adjustments to amounts previously billed or disbursed. In accordance with FCC Rules and Regulations, the Company records these adjustments in the period they are determined. Management does not believe that the impact of these adjustments is material to the financial statements presented.

Statements of Cash Flows

The statements of cash flows include all cash flow activity relating to USAC and the Support Mechanisms.

3. RESTRICTED NET ASSETS AND NET LIABILITIES

In connection with USAC's administration of the Support Mechanisms (Note 1), USAC collects monies and makes disbursements between various telecommunications providers, as specified by the FCC. The following summary statements of net assets applicable to Federal USF, summary statements of activities and summary statements of cash flows are provided for additional information.

UNIVERSAL SERVICE ADMINISTRATIVE COMPANY

NOTES TO FINANCIAL STATEMENTS
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(in thousands)

	2002					2001				
SUMMARY STATEMENT OF NET ASSETS APPLICABLE TO FEDERAL USF	High Cost	Low Income	Schools & Libraries	Rural Health Care	Total USF	High Cost	Low Income	Schools & Libraries	Rural Health Care	Total USF
ASSETS:										
Restricted cash and cash equivalents	\$ 101,212	\$ 47,713	\$1,923,830	\$ 12,876	\$2,085,631	\$ 104,825	\$ 53,772	\$1,785,425	\$ 7,507	\$1,951,529
Short-term investments (Note 2)			275,141		275,141	-	-	431,723	-	431,723
Receivable from contributors	331,632	74,798	230,191	3,636	640,257	304,889	53,474	238,284	1,241	597,888
Allowance for doubtful accounts (Note 2)	(59,436)	(15,184)	(46,961)	(1,476)	(123,057)	(53,100)	(12,300)	(40,900)	(530)	(106,830)
Interest receivable	86	53	3,489	16	3,644	659	739	4,637	24	6,059
Total assets	373,494	107,380	2,385,690	15,052	2,881,616	357,273	95,685	2,419,169	8,242	2,880,369
LIABILITIES:										
Payable to service providers	278,320	52,602	20,446	-	351,368	225,221	49,063	22,071	-	296,355
Payable to contributors	19,468	4,250	12,773	219	36,710	4,766	822	3,622	24	9,234
Payable to USAC	(146)	(127)	2,692	61	2,480	(791)	(287)	3,177	205	2,304
Total liabilities	297,642	56,725	35,911	280	390,558	229,196	49,598	28,870	229	307,893
Net assets applicable to Federal USF	\$ 75,852	\$ 50,655	\$2,349,779	\$ 14,772	\$2,491,058	\$ 128,077	\$ 46,087	\$2,390,299	\$ 8,013	\$2,572,476

	2002					2001				
SUMMARY STATEMENT OF ACTIVITIES	High Cost	Low Income	Schools & Libraries	Rural Health Care	Total USF	High Cost	Low Income	Schools & Libraries	Rural Health Care	Total USF
ADDITIONS:										
Amounts billed to contributors	\$2,548,280	\$627,475	\$2,065,543	\$ 27,386	\$5,268,684	\$2,727,169	\$573,329	\$2,126,245	\$ 10,483	\$5,437,226
Interest income	511	666	40,131	262	41,570	4,044	4,858	63,197	430	72,529
Total additions	2,548,791	628,141	2,105,674	27,648	5,310,254	2,731,213	578,187	2,189,442	10,913	5,509,755
DEDUCTIONS:										
Amounts paid and due to service providers	2,976,294	675,912	1,660,196	16,850	5,329,252	2,600,596	577,594	1,465,372	8,428	4,651,990
Allowance for doubtful accounts	6,336	2,884	6,061	947	16,228	36,559	7,918	28,120	249	72,846
Operating expenses	6,852	1,870	34,387	3,083	46,192	5,151	1,394	30,150	2,589	39,284
Total deductions	2,989,482	680,666	1,700,644	20,880	5,391,672	2,642,306	586,906	1,523,642	11,266	4,764,120
INTERPROGRAM TRANSFER (Note 5)	388,466	57,093	(445,550)	(9)	-	-	-	-	-	-
Change in net assets	(52,225)	4,568	(40,520)	6,759	(81,418)	88,907	(8,719)	665,800	(353)	745,635
NET ASSETS, beginning of year	128,077	46,087	2,390,299	8,013	2,572,476	39,170	54,806	1,724,499	8,366	1,826,841
NET ASSETS, end of year	\$ 75,852	\$ 50,655	\$2,349,779	\$ 14,772	\$2,491,058	\$ 128,077	\$ 46,087	\$2,390,299	\$ 8,013	\$2,572,476

UNIVERSAL SERVICE ADMINISTRATIVE COMPANY

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SUMMARY STATEMENT OF CASH FLOWS	2002					2001				
	High Cost	Low Income	Schools & Libraries	Rural Health Care	Total USF	High Cost	Low Income	Schools & Libraries	Rural Health Care	Total USF
CASH FLOWS FROM OPERATING ACTIVITIES:										
Cash received from contributors	\$2,499,739	\$600,202	\$2,049,909	\$ 24,772	\$5,174,622	\$2,662,934	\$575,891	\$1,989,194	\$ 10,695	\$5,238,714
Cash paid to service providers	(2,887,085)	(663,090)	(1,629,281)	(16,441)	(5,195,897)	(2,605,066)	(576,526)	(1,433,266)	(8,736)	(4,623,594)
Cash paid to USAC for administrative expenses	(6,185)	(1,703)	(34,776)	(3,220)	(45,884)	(5,622)	(1,778)	(28,827)	(2,396)	(38,623)
Interest received	1,452	1,439	41,522	267	44,680	3,419	4,150	87,686	396	95,651
Intraprogram transfers (Note 5)	388,466	57,093	(445,550)	(9)	-	-	-	-	-	-
Net cash provided by (used for) operating activities	(3,613)	(6,059)	(18,176)	5,369	(22,479)	55,665	1,737	614,787	(41)	672,148
CASH FLOWS FROM INVESTING ACTIVITIES:										
Redemption of short-term investments	-	-	588,342	-	588,342	-	-	2,025,627	-	2,025,627
Purchase of short-term investments	-	-	(431,761)	-	(431,761)	-	-	(1,495,113)	-	(1,495,113)
Net cash provided by investing activities	-	-	156,581	-	156,581	-	-	530,514	-	530,514
CASH FLOWS FROM FINANCING ACTIVITIES:	-	-	-	-	-	-	-	-	-	-
Increase (decrease) in cash and cash equivalents	(3,613)	(6,059)	138,405	5,369	134,102	55,665	1,737	1,145,301	(41)	1,202,662
CASH AND CASH EQUIVALENTS, beginning of year	104,825	53,772	1,785,425	7,507	1,951,529	49,160	52,035	640,124	7,548	748,867
CASH AND CASH EQUIVALENTS, end of year	\$ 101,212	\$ 47,713	\$1,923,830	\$ 12,876	\$2,085,631	\$ 104,825	\$ 53,772	\$1,785,425	\$ 7,507	\$1,951,529

UNIVERSAL SERVICE ADMINISTRATIVE COMPANY

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2002 AND 2001 (in thousands)

4. INCOME TAXES

USAC is a not-for-profit organization subject to income taxes related to permanent and temporary differences such as meals and entertainment expense and financial accounting versus tax depreciation. Income taxes for the 2002 and 2001 period are not material and are included as a component of administrative costs.

5. INTERPROGRAM TRANSFERS

On June 13, 2002, the FCC released Docket No. 02-6, directing USAC to apply unused Schools and Libraries Support Mechanism funds to stabilize the USF contribution factor. Based upon projected demand and projected contributions, USAC transferred unused Schools and Libraries Support Mechanism funds to the other Support Mechanisms.

6. COMMITMENTS AND CONTINGENCIES

Commitments to Schools, Libraries and Rural Health Care Facilities

The management of USAC has developed operational procedures to administer the application process through which eligible schools and libraries and rural health care providers apply for universal service funding. These operational procedures enable USAC to review and process applications resulting in funding commitment letters that are issued to eligible schools and libraries and rural health care providers. Funding commitments made to eligible schools and libraries and rural health care providers are not fixed and are not binding for either USAC or the schools and libraries and rural health care providers applying for funding. At any point in time, funds committed could potentially exceed funds available due to the nature of the process, the volume and timing of application receipt and approval, the timing of collections and the extent to which several funding years may be open at that point in time. USAC also receives funds returned by service providers and applies those funds to reduce the disbursements against commitments to schools, libraries, and rural health care providers.

UNIVERSAL SERVICE ADMINISTRATIVE COMPANY

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2002 AND 2001 (in thousands)

Fixed Contract Commitments

IBM Agreement

On May 10, 2001, USAC entered into an agreement with PricewaterhouseCoopers, LLP ("PwC Agreement") for billing, collection and disbursement services for USAC. The PwC Agreement was a five-year contract, for the period July 1, 2001 to June 30, 2006. On October 1, 2002, IBM Consulting ("IBM") purchased PricewaterhouseCoopers Consulting, resulting in an assignment of USAC's contract to IBM ("IBM Agreement"). In January 2003, the FCC directed USAC to terminate the IBM Agreement. USAC's board of directors approved a course of action to negotiate a termination of the IBM Agreement and develop a plan to perform the billing, collection and disbursements in house. The impact of the decision to terminate the contract has not yet been determined.

The following amounts represent the full contractual obligations due per year under the IBM Agreement in effect at December 31, 2002:

2003	\$4,295
2004	4,478
2005	4,642
2006	2,352

LaSalle Bank Agreement

On May 1, 2001, USAC entered into an agreement with LaSalle Bank ("LaSalle Agreement"). The LaSalle Agreement is a five-year contract, which runs from July 1, 2001 to June 30, 2006. Under the terms of the LaSalle Agreement, LaSalle provides banking and investment management services for a fixed annual contractual amount that may be satisfied by fees derived by LaSalle from the investment of a portion of the custodial assets. LaSalle has also agreed to share with USAC the fees it earns for managing the investments after the annual fee has been satisfied. In accordance with the LaSalle Agreement, USAC earned \$2,088 and \$984 for the years ended December 31, 2002 and 2001, respectively which is reflected as a reduction in operating expenses in the accompanying financial statements. The fees earned are dependent on the amounts invested and will vary over the term of the contract.

UNIVERSAL SERVICE ADMINISTRATIVE COMPANY

NOTES TO FINANCIAL STATEMENTS

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The future contractual required payments per year under the LaSalle Agreement are as follows:

2003	\$ 950
2004	974
2005	1,027
2006	528

NECA Agreement

On May 1, 2000, USAC entered into an agreement with NECA ("NECA Agreement"). The NECA Agreement was a three year contract, which runs from July 1, 2000 to June 30, 2003. Effective July 1, 2002, the NECA Agreement was amended and extended to June 30, 2005 with renewal options through June 30, 2008. Under the terms of the new agreement, NECA is to provide programmatic support service to the Schools and Libraries and Rural Health Care Support Mechanisms. The future contractual required payments per year through June 30, 2005 under the new NECA Agreement are as follows:

	<u>Schools and Libraries</u>	<u>Rural Health Care</u>
2003	\$28,065	\$1,991
2004	26,301	2,210
2005	13,277	1,169

Lease Commitments

USAC leases its office space under three operating lease agreements expiring at various dates through March 2004. At December 31, 2002, the future minimal rental payments under these leases are as follows:

2003	\$596
2004	67

Rent expense under operating leases was \$330 and \$288 for the years ended December 31, 2002 and 2001, respectively.

UNIVERSAL SERVICE ADMINISTRATIVE COMPANY

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2002 AND 2001 (in thousands)

Legal Disputes

The Company is involved in various legal proceedings and claims incidental to the normal conduct of its business. Among other matters, the Company was named as a third-party defendant in a judicial proceeding in the Commonwealth of Puerto Rico asserting the claim that a Schools and Libraries Universal Service Support Mechanism funding commitment was a binding contract breached by the Company. The third-party plaintiff, who failed to exhaust its administrative remedies as required by law, seeks \$70 million in unspecified damages. Although it is impossible to predict the outcome of this or any of the other outstanding legal proceedings involving the Company, the Company believes that such outstanding legal proceedings and claims, individually and in the aggregate, are not likely to have a material effect on its financial position or results of operations.

7. RETIREMENT PLANS

USAC has a 401(k) Retirement Savings Plan covering all USAC regular employees. The plan is both contributory and noncontributory and all contributions are subject to certain limitations as prescribed by the plan document and government regulations. Employees are immediately vested in the employer contribution, which is funded on a current basis. Employer contributions charged to operations was \$439 and \$298 during 2002 and 2001, respectively.

8. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In June and August 2001, the Financial Accounting Standards Board, or FASB, issued SFAS No. 143, "Accounting for Asset Retirement Obligations" and No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," respectively. SFAS No. 143, which is effective for the Company on January 1, 2003, requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. The Company does not expect that the adoption of SFAS No. 143 will have a material impact on its financial position, operations or cash flows. SFAS No. 144, which was effective for the Company on January 1, 2002, supersedes current accounting literature and now provides for a single accounting model for long lived assets to be disposed of by sale and discontinued operations presentation. The adoption of this statement did not have a material effect on the Company's financial statements.